



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date:	08/12/13	Bill No:	Assembly Bill 781
Tax Program:	Sales and Use California Tire Fee eWaste Fee	Author:	Bocanegra
Sponsor:	BOE	Code Sections:	RTC 7153.6 & 55363.5
Related Bills:		Effective Date:	01/01/14

BILL SUMMARY

This bill makes it a punishable offense for any person to knowingly sell, purchase, install, transfer or possess software programs that falsify reported sales, as specified.

Summary of Amendments

Since the previous analysis, the bill was amended to exclude corporations that possess such hardware or software to develop ways to combat tax evasion resulting from the use of automated sales suppression devices or software.

ANALYSIS

CURRENT LAW

Existing California law¹ sanctions taxpayers who intentionally fail to accurately report and remit tax and fee liabilities. In addition to a variety of civil penalties, the law imposes criminal penalties for violations. For example, any person who makes a fraudulent return with the intent to evade the determination of an amount due, or any person who assists in the preparation or presentation of a document that is false as to a material matter is guilty of a misdemeanor, punishable by a fine of at least \$1,000 and not more than \$5,000, or imprisonment up to one year in the county jail, or both the fine and imprisonment in the court's discretion. In addition, the law makes it a felony if the unreported tax liability is at least \$25,000 in a consecutive 12-month period, punishable by a fine of at least \$5,000 and not more than \$20,000, or imprisonment for 16 months, or 2 or 3 years, or both the fine and imprisonment in the discretion of the court.

The existing Fee Collection Procedures Law² (FCPL) generally provides for the administration of fees collected by the Board of Equalization (BOE). Legislation that establishes a new fee may reference the FCPL with minimal verbiage. Among other things, this law includes collection, reporting, refund, and appeals provisions, and, similar to the Sales and Use Tax Law, provides criminal penalties for violations.

Existing law does not specifically penalize a person for the sale, purchase, installation, transfer, or possession of sales suppression devices or software that conceals or removes sales transactions from retailers' recordkeeping systems.

¹ Revenue and Taxation Code (RTC) Sections 7152 through 7157.

² Part 30 of Division 2 (commencing with Section 55001) of the RTC.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

PROPOSED LAW

This bill makes it a misdemeanor for any person who purchases, installs, or uses in this state any specified sales suppression devices with the intent to defeat or evade the determination of an amount due.

In addition, the bill makes it a punishable offense for any person who, for commercial gain, purchases, installs, or uses in this state any specified sales suppression devices with the knowledge that the sole purpose of the device is to defeat or evade the determination of an amount due. The offense is punishable by a fine and/or imprisonment in the county jail for not more than one year, or for 16 months, or for two or three years. For a person guilty of selling, installing, transferring or possessing three or fewer sales suppression devices, a fine of up to \$5,000 may be imposed. For a person who sold, installed, transferred, or possessed more than three sales suppression devices, a fine of up to \$10,000 may be imposed.

The provisions do not apply to a person that is a corporation that possesses automated sales suppression devices or phantom-ware for the sole purpose of developing hardware or software to combat tax evasion by use of such devices or software.

The bill applies to the Sales and Use Tax Law, and the California Tire Fee and the Covered Electronic Waste Recycling Fee, which are fees imposed on consumers at the retail level and which are collected and administered under the FCPL.

The bill specifies that the person shall also be liable for the taxes and fees, interest, and penalties due.

The bill defines “automated sales suppression device,” “zapper,” “electronic cash register,” “phantom-ware,” and “transaction data.”

BACKGROUND

California’s tax system is based on voluntary compliance. Most tax or feepayers (taxpayers) who report taxes and fees to the BOE are honest and generally comply with the law. However, some seek to skim or hide their sales to evade the tax due. Some cash-based businesses, for example, do not ring up all their sales through their cash register, keep two sets of books, or simply file false tax returns.

Now, an electronic method to skim sales allows retailers to conceal or remove sales transactions from recordkeeping systems. These devices are referred to as “sales suppression devices,” and the software is referred to as “phantom-ware.” The use of this technology makes the detection of understated sales difficult in tax and fee audits.

COMMENTS

1. **Sponsor and purpose.** As sponsors of this bill, the BOE Members believe that California must be proactive and curtail the sale and use of these sales suppression devices. Use of this technology not only defrauds the state, but also provides users an unfair competitive advantage over taxpayers who comply with the law and pay their fair share of taxes and fees. The Legislature has recognized through its enactment of criminal penalties for deliberate taxpayer fraud and evasion that criminal sanctions play an important role in tax administration. Specifically criminalizing and punishing the sale, installation, and use of sales suppression devices serves as a strong deterrent to potential manufacturers, sellers, installers, and users of these devices.

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2. **The August 12, 2013 amendments** exclude from the provisions a corporation that possesses the sales suppression devices or software for the sole purpose of developing hardware or software to combat tax evasion resulting from the devices covered in this bill. **The July 9, 2013 amendments** provided that a person who (1) purchases, installs, or uses in this state any specified sales suppression devices with the intent to defeat or evade the determination of an amount due is guilty of a misdemeanor, and (2) sells, purchases, installs, transfers, or possesses for commercial gain specified sales suppression devices with the knowledge that the sole purpose of the device is to defeat or evade the determination of an amount due, is guilty of a punishable offense, as specified. **The April 18, 2013 amendments** removed the felony classification, and made the criminal offense punishable by a fine up to \$10,000 and/or three years imprisonment. The amendments also deleted the provision that would have required the person found guilty to forfeit to the state all profits associated with these devices use.
3. **Other states have banned these devices and software.** In 2011, [Georgia](#) became the first state to make it a crime to knowingly sell, purchase, install, transfer, or possess any automated sales suppression device or zapper or phantom-ware. Several other states have since enacted similar provisions, including [Connecticut](#), [Michigan](#), [Louisiana](#), [Maine](#), [Tennessee](#), and [West Virginia](#). Others, including [Indiana](#) and [New York](#), have proposed legislation outlawing these devices and software.
4. **Specific incidents of sales suppression software cases.** According to information obtained from the [Federation of Tax Administrators'](#) (FTA) website, examples of United States zapper cases involving substantial underreported sales include :
 - Connecticut: The IRS discovered in an income tax audit that a grocery store had \$17 million in underreported sales.
 - Michigan: The CIA uncovered information from a restaurant chain owner's relative that the restaurant neglected to report \$20 million in sales.
 - Ohio: The FBI and the Joint Terrorism Task Force detected that a restaurant chain underreported \$3 million in sales.
 - New York: A *New York Post* article disclosed an undercover sting operation where 70 percent of electronic cash register sellers had tried selling zapper software with the systems they offered to potential customers.

COST ESTIMATE

The administrative costs are absorbable.

REVENUE ESTIMATE

Currently, the BOE staff is studying the extent of California's sales suppression software problem in California. Based on BOE data for 2010, California's dining and beverage industry reported taxable sales of \$51.3 billion. Using a 5% underreporting rate, California loses \$214 million³ annually due to use of these sales suppression devices.

If enacted, we anticipate these estimated losses will decrease. However, the extent of the decrease is unknown.

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³ Based on California's average 2013 state, local, and district tax rate of 8.38%.

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